#702

IN THE CIRCUIT COURT FOR THE THIRD JUDICIAL CIRCUIT
MADISON COUNTY, ILLINOIS

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DONNA CRAIN, et al., Plaintiffs,	)	
v.	)	Case No. 96-LM-983
LUCENT TECHNOLOGIES, et al., Defendants.	)	

REPLY OF FEDERAL COMMUNICATIONS COMMISSION IN SUPPORT OF ITS MOTION FOR LEAVE TO FILE MEMORANDUM AS AMICUS CURIAE

The Federal Communications Commission ("FCC" or "the Commission") has asked the Court's leave to file a memorandum as amicus curiae addressing the issue of preemption. The Court's March 10, 1999 Order dismissing the complaint in this case had relied entirely on FCC orders in finding that the plaintiffs' claims were "preempted by federal law." The FCC sought, through its amicus filing, to inform the Court of its own views as to the meaning of its orders in the context of preemption. The FCC expressly took no position on the merits of the plaintiffs' claims, but sought only to advise the Court of its intentions in the orders that had formed the basis for the March 10, 1999 dismissal order.

In opposition to the Commission's motion for leave, the defendants argue (1) that Illinois procedures do not contemplate amicus participation at the trial court level, (2) that the Commission's memorandum is not a proper amicus filing in any event because it "advocate[s] one party's position over another's," and (3) that the Commission has misunderstood both this Court's preemption ruling and the Commission's own earlier orders. The defendants also (4) respond on the merits to the Commission's memorandum, and present their counsels' recitation as to the nature and content of conversations in which FCC counsel informed the defendants' counsel of the agency's intention to submit an amicus filing. We respond as follows to defendants' opposition:

(1). The FCC does not presume to advise the Court as to its authority to accept the FCC's amicus memorandum. It does, appear, however, that an Illinois circuit court, in some instances, can allow amicus participation, and that the general rule is that such participants may not engage in substantive motions practice. See Petition to Call an Election on the Question of Incorporating the Village of Forest Knoll, 164 Ill.App.3d 392, 393, 517 N.E. 2d 1188, 1190 (1987).[1] The parties may more appropriately brief this procedural issue, but it is important to note that the FCC has not sought to file a motion in this proceeding other than its motion for leave to participate as amicus curiae through submission of its proposed brief. Moreover, a specific federal statute, 28 U.S.C. § 517, provides that the Attorney General may send any official of the Department of Justice "to any State or district in the United States to attend to the interests of the United States in a suit pending in a court of the United States, or in a court of a State, or to attend to any other interest of the United States." See Lasidi, S.A. v. Financiera Avenida, S.A., 73 N.Y.2d 947, 948, 538 N.E. 2d 332, 540 N.Y.S. 2d 980, 981 (1989) (noting submission by United States Attorney General of a "suggestion of interest" concerning an issue of diplomatic immunity in context of a discovery dispute).

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[1] Illinois appellate courts have permitted other federal agencies to participate as amicus curiae in such appeals. See National Commercial Banking Corp. of Australia, Ltd. v. Harris, 125 Ill.2d 448, 451; 532 N.E.2d 812, 813; 126 Ill. Dec. 941, 942 (1988)(Office of Comptroller of the Currency); Coldwell Banker Residential Real Estate Services of Illinois v. Clayton, 105 Ill.2d 389, 392; 475 N.E.2d 536, 537; 86 Ill. Dec. 322, 323 (1985)(Federal Trade Commission); Olsen v. Financial Fed. Sav. & Loan Ass'n, 105 Ill.App.3d 364, 434 N.E.2d 406, 407; 61 Ill. Dec. 322, 323 (1982)(Federal Home Loan Bank Board).

(2). The Commission's memorandum expressly declines to take a position on the merits of the plaintiffs' claims and, therefore, does not "advocate one party's position over another's." It does, obviously, take a position on the question of preemption; there would be no purpose in the FCC's submitting a paper that did not. But an amicus filing clearly may take a position that favors one outcome (or even one party) in litigation over another. Indeed, the Federal Rules of Appellate Procedure, which specifically authorize amicus filings in some circumstances, require such filing within seven days after the filing of the brief of the party "being supported." FRAP 29(e) (1999).[2] An amicus should be independent of the parties, but it need not be neutral or indifferent as to the issues it addresses. One seeking to participate as amicus would surely be denied leave if it had no views that were pertinent to the controversy.

(3). The Commission interpreted the Court's March 10, 1999 dismissal order as finding preemption for two reasons, both of them arising from the Commission's actions in detariffing Customer Premises Equipment ("CPE"). First, the Court found that the Commission's program of transition to deregulation had required certain steps by AT&T (and eventually by Lucent Technologies, Inc.) that could not be challenged in a state lawsuit arising from conduct that

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[2] Leigh v. Engle, 535 F. Supp. 418, 421 (N.D. Ill. 1982), cited by defendants, is distinguishable. That court determined that the Secretary of Labor would be denied amicus status in the trial level court because the Secretary supported plaintiffs' legal theories and supported entry to judgment for plaintiffs. Here, the FCC's role is far more limited. See also Waste Management of Pennsylvania, Inc., v. City of York, 162 F.R.D. 34, 36-37 (M.D. Pa. 1995)(permitting amicus participation by Environmental Protection Agency, which had "a special interest in this litigation as it is the primary body responsible for administering and enforcing" the statute at issue); Wilson v. Al McCord, Inc., 611 F. Supp. 621, 622 (W.D. Okla. 1985), a'ffd in part and rev'd in part on other grounds, 858 F.2d 1469 (10th Cir. 1988) (permitting amicus participation by state securities regulator); Grimes by Grimes v. Sobol, 832 F. Supp. 704, 712 (S.D.N.Y. 1993) (permitting amicus letter by federal Department of Education), aff'd, 37 F.3d 857 (2d Cir. 1994); In re Roxford Foods Litig., 790 F. Supp. 987, 997 (E.D. Cal. 1991) (permitting amicus brief by federal Department of Agriculture). .

occurred during the transition period. More broadly, the Court found that the FCC's "regime of deregulation" after the transition, and its intention to rely on the "forces of the market" foreclosed the application of state consumer protection laws to the offerings of CPE by AT&T (and Lucent). It was this second, broad preemption finding that prompted the Commission's submission.

The defendants appear to deny that the Court made such a "broad pronouncement." But the Court's order speaks for itself, and the breadth of its second reason for preemption is clear. See March 10 Order at 2-3. Thus, for example, the Court found that an allegation under state law that AT&T has imposed unconscionable rental charges for CPE, even after the transition, is foreclosed because it is inconsistent with the Commission's determination to rely on market forces after deregulation. That finding, moreover, is directly responsive to the argument made in the defendants' Memorandum of Law in Support of motion for Judgment ... or Alternatively to Dismiss or Stay (filed Jan. 5, 1999), at 17-18. The FCC's proffered amicus memorandum addresses that finding and informs the Court that the Commission had no intention to preempt such scrutiny of AT&T's charges and practices. The Commission's intention with regard to preemption is central to the analysis of an argument that the agency's action has a preemptive effect. E.g., Fidelity Federal Savings & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 154 (1982). Indeed, AT&T and Lucent themselves now have asked the Commission to issue a declaratory ruling on this very question.

(4). The FCC does not reply to the defendants' response on the merits to the FCC's memorandum, on the assumption that an amicus properly presents its views in a single filing and does not engage in debate through subsequent pleadings. Second, the FCC also does not offer its counsels' rejoinder concerning the nature and content of FCC counsel's discussions with counsel for the defendants when the FCC attorney called to inform them of the FCC's intention to offer its views to the Court as amicus curiae, although the FCC does not agree with the defendants' characterization of those discussions in some respects.

CONCLUSION

For the reasons stated in the FCC's motion for leave and in this Reply, the Commission respectfully asks the Court to accept the FCC's memorandum and to consider it in its determination of the preemption issue raised in the pending motion for reconsideration.

Respectfully submitted,

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PROOF OF SERVICE

DONNA CRAIN, et al., Plaintiffs,	)	
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The undersigned hereby certifies that she/he is an employee in the office of the United States Attorney for the Southern District of Illinois and is a person of such age and discretion as to be competent to serve papers.

That on June 11, 1999, she/he served a copy of the attached:

REPLY OF FEDERAL COMMUNICATIONS COMMISSION IN SUPPORT OF ITS MOTION FOR LEAVE TO FILE MEMORANDUM AS AMICUS CURIAE

by placing said copy in a postpaid envelope addressed to the person(s) hereinafter named, at the place(s) and address(es) stated below, which is/are the last known address(es), and by depositing said envelope and contents in the United States Mail at Nine Executive Drive, Suite 300, Fairview Heights, IL 62208.

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Assessment of AT&T and Lucent Telephone Lease Business

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November 2, 2001

I. Introduction

Charlotte TerKeurst is a telecommunications consultant and is a Senior Vice President of Competitive Strategies Group, Ltd., a consulting firm located in Chicago, Illinois. Her consulting practice since 1997 has addressed a wide variety of regulatory, business, consumer, and competition-related issues in the telecommunications industry. Ms. TerKeurst was employed by the Illinois Commerce Commission from 1993 until 1997, most recently as the manager of the Telecommunications Division and, earlier, as director of the Telecommunications Program in the Office of Policy and Planning. She was manager of the Telecommunications Department of the Missouri Public Service Commission from 1991 until 1993. Ms. TerKeurst was employed by the California Public Utilities Commission (CPUC) from 1980 until 1991, holding several positions on the technical staff, as an advisor to the lead CPUC Commissioner on telecommunications issues at the time of divestiture, and later as an administrative law judge handling primarily telecommunications cases. Ms. TerKeurst taught a graduate course in telecommunications regulation at Golden Gate University for five semesters.

Ms. TerKeurst received her B.S. degree in mathematics from the University of Mississippi and her M.S. degree in electrical engineering from the University of Illinois at Urbana-Champaign.

Ms. TerKeurst's opinions are based on her review of depositions, AT&T and Lucent[1] discovery materials, other documents as cited herein, and Ms. TerKeurst's experience and knowledge in this area.

II. The Embedded Consumer Telephone Lease Market is Unique

The embedded consumer telephone lease business is a regulatory creation born in the mid-1980s when the Federal Communications Commission (FCC) deregulated customer premises equipment (CPE) that had been provided by local telephone companies. Until 1968, customers were prohibited from connecting any non-Western Electric devices to the network. In 1977, the FCC implemented a registration program that allows customers to connect registered CPE directly to the network without the use of special protective equipment provided by the telephone company. With that advance, customer-owned telephones began to be available and the market for customer-owned telephones began to grow, although slowly. With divestiture, AT&T inherited the embedded base of consumer telephone leasers, most of whom had never purchased a telephone and became AT&T lease customers by default. It is clear that a requirement that consumers make an affirmative choice between leasing and purchase would have reduced the size of the embedded telephone lease base significantly, because it would have overcome the substantial customer inertia, as described below.

As a regulatory creation, the embedded consumer telephone lease business has no close analogy in markets that were not created by regulatory action. For other consumer services considered public utilities, including electricity, gas, water, and sewer services, consumers (or other building owners) have owned the wires and pipes inside their homes and have provided the appliances or other devices that used the service. The unique situation in which the local telephone utility was also the monopoly provider of CPE arose due to Alexander Graham Bell's telephone patents.[2]

No competitive market has developed for the long-term renting or leasing of consumer telephones, just as there is no market for the long-term rental of other low-cost consumer goods. As an AT&T employee recognized in writing about the uniqueness of the telephone lease business,

> "The economics of leasing small items would change drastically once the equipment ceased to be just one more item on the customer's monthly local service bill. (After all, no one leases toasters and other small appliances.)"[3]

Renting or leasing of consumer goods generally exists for either (1) more expensive items, e.g., automobiles, musical instruments, furniture, or electronics, and/or (2) very short periods to meet transient needs, e.g., videotapes, party goods, tools, or moving trucks. Price/value ratios (the monthly rental rate as a percent of the retail purchase price) for leased consumer goods are generally much lower than AT&T and Lucent have enjoyed, except for rent-to-own arrangements or very short-term rentals.[4] Embedded consumer telephone leasing differs from rent-to-own arrangements in that rent-to-own arrangements are for short periods, and most rent-to-own merchandise is purchased by the customer after a short rental period.[5] Both the short rental period and the fact that the arrangement is rent-to-own would tend to support relatively high price/value ratios. Month-to-month embedded consumer telephone leases have neither of these characteristics. Similarly, for very short-term rentals such as videotapes or tools, the need to recover all transaction costs over a single very short rental period would tend to support relatively high price/value ratios, a characteristic not present for embedded consumer telephone leases.

Consumer telephone lease services are dissimilar to extended warranties, which apply for a set period of time for new consumer goods and generally do not provide for trade-ins. They also differ from service contracts, which provide services such as on-going maintenance and monitoring. Nor are they accurately characterized as insurance, since the purpose of insurance is to provide protection against extremely burdensome costs of unexpected events. The replacement of non-working consumer telephones would not be financially burdensome for the vast majority of pre-1984 customers, particularly in comparison to the cumulative lease payments that they have made.

The embedded consumer telephone lease base differs significantly from new leasers who began leasing after January 1, 1984. New leasers generally lease for short periods.[6] This portion of the consumer lease business is much smaller than the embedded consumer lease business.[7] The profit margins are lower and, in fact, the new lease business has not been emphasized in recent years.[8] New leasers tend to be significantly younger than embedded base leasers.[9]

Some similarities exist between the leasing of telephones to embedded base customers and the provisioning of inside wire maintenance programs by local telephone companies, which is another regulatory creation. As such, any parallels to the inside wire maintenance business should not be viewed as justification for AT&T and Lucent's behavior regarding embedded consumer telephone leases.

AT&T and Lucent have possessed market power in the embedded consumer telephone lease business, as indicated by the revenue and profit increases experienced when prices were raised.[10] The profit margins on the embedded lease business have always been very high and have increased steadily.[11] The price-to-value ratio for AT&T and Lucent's embedded consumer telephone leasing business has been very high and has increased steadily. In marketing efforts, AT&T and Lucent stress the value of the so-called "service" component of leasing. However, AT&T's calculations indicate that its recurring cost of leasing an embedded base telephone was a small fraction of the lease rate, e.g., between $0.60 per month (for traditional rotary telephones) and $0.94 per month (for trimline touchtone telephones) in 1994.[12] About half of the reported recurring expenses were direct expenses and about half were due to an allocation of Consumer Services expenses. AT&T and Lucent have known that they have had market power, as indicated by their findings that non-cost based rate increases would increase revenues, that many customers lack knowledge needed to make informed choices and continue leasing due to inertia, and that dissemination of information would increase erosion.

In light of the high profit margins enjoyed by AT&T and Lucent, the fact that other providers did not step in and offer a comparable consumer leasing program in the BOC service areas[13] indicates that the profitability of a consumer leasing program hinges on access to embedded base customers and on use of the AT&T brand, advantages that competitors would not have. AT&T was aware of its competitive advantages due to the embedded base and use of the AT&T brand and reputation.[14]

During the two-year period (1984 and 1985) when AT&T was required to offer in-place telephones for sale, fewer than half of leasers purchased their telephones. AT&T's consumer telephone lease base declined from about 83 million leased telephone sets in service on January 1, 1984 to about 46 million leased sets in service on January 1, 1985. The number of consumer-leased telephone sets declined to about 12 million by the beginning of 1993, and declined further to 3 million in 2000.[15]

AT&T and Lucent have gathered extensive information regarding characteristics of leasers and why they continue to lease. Multiple studies commencing as early as 1985 have indicated that certain segments of the population are more likely to continue leasing than others, in particular, leasers tend to be less affluent, older, less educated, single-person households, and/or impaired people, compared to consumers who own all of their telephones.[16] AT&T had knowledge even before January 1, 1984 that inertia could slow the rate at which consumers left the lease base,[17] and had information by 1985 that most customers who continued to lease did so for apathy, habit, or inertia-related reasons.[18] It had information by 1987 that older customers exhibit more inertia than general leasers.[19] AT&T had information by 1991 or 1992 that older customers were less likely than younger customers to stop leasing following price increases.[20] AT&T and Lucent had information that leasers who have not modularized their phones tend to be older, less educated, and poorer, and tend to have fewer persons in the household.[21] AT&T had information by 1991 that customers who had not modularized their phones are less likely to stop leasing than are customers with modularized phones.[22] That study also confirmed that the embedded lease base was aging as younger customers left leasing disproportionately.[23]

AT&T sometimes has compared residential lease customer demographics with demographics of the U.S. population using U.S. census data, citing, for example, that lease customers have higher education levels than the population as a whole.[24] Such comparisons are misleading and of limited value, for several reasons. Lease customers are, on average, significantly older than the average U.S. resident and, thus, are more likely to have completed their education. As an example, AT&T reported that 2% of lease customers were between 18 and 24 years old in 1994, compared to 15% of the U.S. population. A comparison of annual household incomes for lease customers and the U.S. population is also of limited value, since lease customers are more likely to be retired and, at the same time, less likely to still be in school. Additionally, U.S. census data includes people who do not have telephone service and, thus, are not in a position to either own or lease telephones. Comparisons of consumers who lease their telephones and consumers who have purchased their telephones are more informative than comparisons of leasers with the U.S. population as a whole, and the value of such comparisons would increase if they are broken down by age group.

AT&T and Lucent's ability to earn extraordinary profits from the embedded consumer telephone lease business can be attributed to a combination of factors, including the following:

- Some customers have continued to lack the knowledge needed to make a reasoned choice between leasing and purchasing. There was widespread confusion following divestiture regarding the services and responsibilities of AT&T and the local telephone company.[25] Some customers do not know they are leasing,[26] from whom they are leasing,[27] or that their leased phone can be replaced by a purchased one.[28] Customers do not know the lease terms and conditions,[29] the likelihood of repair problems, how to terminate a lease, or how to compare costs of leasing and purchasing.

- Following divestiture, some customers have continued to view AT&T as a public utility, and have continued to "trust the phone company" to act in the public interest, as a holdover from the days of government regulation as a public utility.

- AT&T has widespread brand awareness and enjoys a reputation for quality and reliability.[30]

- Some customers like their leased telephone and do not want to relinquish it.[31] They may not have understood the purchase option when it was available, or that the purchase option would terminate.

- Some customers have continued to lease because of inertia, habit, and/or apathy. These customers "inherited" their leases from monopoly days.[32] Lease payments have been relatively small, and easy to "fall off the radar screen" in terms of not being important enough for a customer to focus on. In fact, some customers are unaware of the lease rates.[33] They have lacked, and have had difficulty obtaining, information. Some of them have not wanted to deal with the process of purchasing phone and terminating their lease. Some of them are "invested" in leasing and have had trouble acknowledging that they had not made a wise choice.

- Some customers still have hardwired phones.[34] Many older customers, in particular, lack the knowledge or ability to modularize phones. Some of them are afraid to modularize. The modularization process entails a shock hazard, which is an impediment for those customers who do not know how to protect against it or who have only one telephone and no modular network interface and thus cannot protect against it. The cost of paying someone else (including AT&T or Lucent) to modularize has been an impediment to modularization for some customers.

III. AT&T and Lucent Took Improper Advantage of the Embedded Lease Base

AT&T and Lucent knowingly have taken advantage of the embedded lease base to charge unconscionable prices and extract unconscionable profits from customers least able to obtain information, assess their options, and make wise choices. They viewed the embedded lease business as a "money tree" whose wealth could be "harvested" with little effort.[35] They recognized, however, that the value of the lease business would decline over time[36] and that a major threat was customer awareness.[37]

AT&T and Lucent's corporate goals for the lease business of profit maximization, cost reduction, and customer retention[38] are at odds, since price increases and changes in lease terms and conditions that reduce the value of the lease to customers increase erosion. These corporate goals mean that prices should be increased while costs--and therefore benefits--are reduced while customer erosion is held in check. These competing goals set the stage for purposeful deception, misinformation, and creation of other barriers to lease termination. At the same time that AT&T and Lucent have reduced the value of the lease, they have attempted to create an illusion that benefits have increased. Other practices have ill-informed and confused customers.

A. Lease Charges and Profits Have Been Unconscionably High

AT&T and Lucent's charges for the lease of consumer telephones have been unconscionably high.[39] Lease rates and profits[40] increased dramatically at the same time that industry-wide sales prices[41] and the book value of the embedded base telephones[42] went down. AT&T raised lease rates for embedded base telephones far in excess of inflation. While the Consumer Price Index (CPI) increased by 43% between 1984 and 1994,[43] overall Big Six lease rates increased by 105%, almost 2.5 times as much as the CPI increases.[44] Lease rates for traditional rotary telephones--leased most commonly by the oldest customers—were increased by 197%, almost tripling and over 4.5 times the CPI increases. If telephone prices had increased at the same rate that lease rates increased, AT&T's traditional rotary telephone would have cost $119 by 1994, compared to its 1984 sale-from-inventory price of $39.95. The fact that leasing has become much more expensive compared to purchase options is confirmed by AT&T's own assessments that the ratio between average telephone prices and AT&T lease rates dropped from 12:1 to 5:1 between 1984 and 1996.[45]

In addition to increases in monthly lease charges, lease terms and conditions have been changed in ways that increase costs to customers and reduce the value of leasing a telephone. When AT&T changed the billing to three months in advance for most customers,[46] this had the effect of a rate increase because of the time value of money.[47] As described in Section III.B below, between 1986 and 1994 AT&T more than doubled charges for premises visits.

Charges for unreturned telephones have greatly exceeded the loss suffered and have been unreasonably high. Charges for unreturned telephones should be based on the actual costs incurred by AT&T when a customer does not return the telephone, consistent with the concept of damages for breach of contract. The fact that the level of charges for unreturned telephones was not disclosed ahead of time to customers makes the excessive charges more egregious. In most instances, AT&T did not replace unreturned telephones, since the number of telephones returned as customers terminated leases or exchanged telephones far exceeded the number needed for new placements.[48] The original Unrecovered Telephone Equipment Charge (UTEC) was equal to the Sale-in-Place (SIP) charge and ranged between $27.95 and $54.95 for Big Six telephones. The UTEC was replaced in July 1993 by an Equipment Recovery Charge (ERC), which until January 1996 was calculated to include equipment replacement, recovery cost, and a charge for the loss of an asset and ranged between $22.18 and $36.79. In January 1996, AT&T modified the ERC to base it on the costs that are actually incurred, and the ERC fell to $9.35 for most telephones, $12.26 for trimline touchtone phones, and $24.86 for traditional touchtone phones. The ERC was reduced again in 1999, to $7.00 for all embedded base telephones, based on a reassessment of incurred costs.[49] The unreturned telephone charges prior to January 1996 and any other charges after that time that did not reflect actually incurred costs were not justified by any legitimate economic interest and are unreasonable and excessive. AT&T recognized this when it changed the methodology of calculating the ERC in 1996 to reflect actual damages in order "to defend ERC billing."[50]

AT&T and Lucent have misled customers, their own personnel, and their Consumer Advisory Panel about the basis for price increases by representing that rate increases have been needed in order to maintain service levels and to provide what were in fact only token additional benefits.[51] In reality, profit margins were already excessive and the price increases were undertaken solely to increase profits based on an assessment of what the market would bear.[52] The misleading justifications of price increases fed on customer misunderstanding of lease benefits and their perceived value. The terms "repricing"[53] and "rate alignment"[54] were misleading because all of the price changes were increases, with no decreases.

B. Lease Benefits Have Been Overblown, and Terms and Conditions Have Been Inadequately Disclosed

From the very beginning, AT&T's lease program has been designed to take advantage of the embedded lease base. It was set up as a negative option, i.e., AT&T assumed when the embedded lease business was transferred upon divestiture that a customer wanted to continue leasing the telephone unless the customer took active steps to stop leasing.

To the extent AT&T and Lucent have disclosed the terms and conditions of the lease program, they have focused on "benefits"[55] and have omitted or misrepresented several material limitations or costs of the program. As a result, customer decisions regarding whether to lease or purchase have been based on incomplete, incorrect, and misleading information. As AT&T acknowledged in 1991, "Taken in total, consumers perceive the AT&T lease offer to be better than the actual offer."[56]

AT&T and Lucent knowingly reduced lease benefits and increased non-recurring lease costs without adequate disclosure to customers,[57] contrary to the representation in Lease Service Contracts that customers would be notified of any material changes in lease terms and conditions. Month-to-month leasing has permitted AT&T and Lucent to alter terms and conditions at will. Since AT&T and Lucent have never provided a comprehensive list of lease terms and conditions, modified terms and conditions could be conveyed to customers (to the extent they were conveyed) without customers realizing that the value of the lease had been reduced.

In the mid-1990s, AT&T made several changes to its lease program that it identified as being in response to challenges by individuals, consumer groups, and government agencies.[58] Most of these changes were self-serving and did not respond fully to the criticisms. Most of the changes involved additional or modified written communications with customers and are discussed in Section III.E below. Standardization of adjustment policies is discussed in Section III.D. Premises visit policies, time-based and trade-up discounts, and modular converters are discussed in this section.

Many of the "benefits" that AT&T and Lucent have cited in marketing the lease program have undisclosed limitations and/or are insubstantial, misleading, and/or self-serving:

- Real benefits (with limitations): free replacement of broken telephones (unless the telephone was "abused"), free color change (except for party-line customers), ability to exchange telephones at Phone Centers or outsourced service agencies (except that Phone Centers declined in number and then closed, and were not replaced by a comparable number of service agencies), 800 number (when the computer system is available), free delivery (implemented in 1990 for non-expedited delivery), postage-paid mailing envelope for return of phone (not always disclosed).

- Misleading benefits: "scheduling" a premises visit, "arranging" for expedited delivery, quarterly billing.

- Insubstantial benefits: automatic lease payment plan; offers of product upgrades or additional leased equipment; time-based and trade-up discounts; free replacement of long cords, cordless antennas, batteries, and answering machine tapes; "AT&T quality;" arranged premises visits; ability to continue leasing after a move; no early termination charge for leased products returned within 3 days after receipt.

- Self-serving: automatic lease payment plan, offers of product upgrades or additional leased equipment; time-based and trade-up discounts, ability to continue leasing after a move.

The following paragraphs describe several areas of concern regarding terms and conditions of the lease program.

Lease Termination. AT&T and Lucent have not disclosed adequately how to terminate a lease. The 1993 Lease Service Contract stated vaguely that "If at any time you decide to discontinue leasing, you are responsible for returning the product to AT&T or paying an Equipment Recovery Charge," without explaining how to do returns. The 1995 and subsequent Lease Service Contract updates provided additional information that the customer could discontinue leasing by taking the leased equipment to a Phone Center or service agency or by returning the phone by mail, but did not disclose that AT&T would send a pre-paid mailer upon request for discontinuances.[59] Even after a customer called and informed Lucent that he/she was terminating, Lucent did not disclose the free mail-in option unless the customer declined to return the telephone to a Phone Center or service agency.[60]

Access to Phone Centers and Service Agencies. The number of Phone Centers available for lease customers declined[61] following the transfer of the leasing business to AT&T,[62] with no notice to customers. AT&T closed all of its remaining Phone Centers in 1996.[63] While AT&T pledged to increase the number of service agencies by more than the number of closed Phone Centers, that promise did not materialize.[64] The number of service agencies has continued to decline.[65] Service agencies are not as full-service as Phone Centers and have less selection.[66] Service agencies are typically stores such as hardware stores or pharmacies, which are more difficult to locate because they are not clearly identified or advertised, and which have less trained/expert personnel who also have other duties.[67] Because of these changes, customers have had access to lower levels of service and many customers have had to travel farther to obtain that service, compared to the time they commenced leasing. Customers were not notified that the value of leasing declined due to these changes.

Access to Assistance through the 800 Number. AT&T misrepresented until 1996 that customers could receive assistance around-the-clock through the 800 number.[68] While the 1996 Lease Service Contract and subsequent communications no longer specify 24-hour assistance, customers are not informed of the hours that assistance is available via the toll-free number.

Premises Visits. AT&T and Lucent have not disclosed the level of charges for premises visits or when charges for premises visits changed. The widely-used language stating that AT&T will "schedule" a technician visit does nothing to dispel the widely-held customer belief that premises visits are free[69] and, in fact, can be read to imply that premises visits are free. Premises visit charges have been increased by much more than inflation. In 1986, AT&T charged $15 for premises visits to modularize outlets and $25 for other premises visits.[70] Afterward, AT&T began billing for premises visits based on the length of time required to do the work."[71] In November 1994, premises visit charges for modularization were $30 for the first outlet and $15 per quarter hour for additional outlets, and charges for other premises visits were $60 for the first 30 minutes and $15 per 15 minutes thereafter.[72] The variable premises visit charges could be substantial.[73] Effective October 23, 1995, premises visit charges were made flat rate, and were set at a $30 for hardwire-to-modular conversions or for party-line modifications, and $60 to move or add a jack.[74]

Hardwired and Party-Line Telephones. AT&T and Lucent have not disclosed adequately the procedures or charges for modifications to hardwired and party-line phones. AT&T and Lucent have not disclosed that customers with party-line telephones have no color or style choices.

Charges for Unreturned Telephones. AT&T and Lucent have not disclosed the level of charges for unreturned telephones (the ERC or, earlier, UTEC). Ongoing representations that the ERC is based upon replacement costs are misleading, since most unreturned telephone sets are not replaced and, for those that are replaced, avoided costs are netted against replacement costs. The representation that replacement costs are charged creates a reasonable inference that the ERC is higher than it actually is.[75] Customers who make that inference would be less inclined to stop leasing and pay the ERC than if they knew the true level of the ERC.

Purchase Policies. AT&T represented to month-to-month leasers that, "You do not have an option to purchase the leased product," whereas in reality until January 8, 1996, customers were allowed to purchase their leased telephones under certain conditions.[76] By not informing any but the most persistent customers that they could purchase their leased telephones, AT&T withheld this important information from customers who otherwise may have left the lease program.

Delivery Charges. AT&T did not disclose the existence or level of charges for delivery. AT&T told consumers in the 1983 notice that replacement phones would be delivered at no charge. However, in early 1989 AT&T was assessing delivery charges, for both regular and expedited delivery.[77] It stopped charging for regular delivery in November 1989[78] but continued charging for expedited delivery.[79]

Fire Losses and Abused Telephones. In 1985, AT&T charged the UTEC (equal to the SIP price) for leased telephones that were damaged through "abuse" or destroyed in fires. The UTEC was assessed regardless of whether an abused telephone was repaired, and regardless of whether the leaser continued to lease.[80] The practice of charging the UTEC for telephones damaged under these conditions violated AT&T's advertised policy that telephones would be replaced free of charge and "no questions asked." AT&T did not disclose this limitation to customers.

In 1995, AT&T charged the ERC (replacing the UTEC) when a leaser terminated following "Acts of God" or abuse of a telephone.[81] The documents provided through discovery do not establish whether AT&T also charged the ERC during that period when a leaser continued to lease under similar conditions. If so, AT&T was violating its Lease Service Guarantee of free replacements no matter what, and was not disclosing that limitation. If AT&T did not charge the ERC for Acts of God or abused telephones when a leaser continued to lease, the differing treatment of telephones damaged through Acts of God or abuse depending on whether the lease was continued created an unfair and discriminatory incentive for lease continuation and an improper barrier to lease termination.

Minimum and Advance Charges. AT&T instituted a three-month minimum billing requirement in the fourth quarter of 1990,[82] which constitutes a reduction in the value of leasing since customers had previously leased month-to-month not subject to these minimum charges. AT&T also reported that it had imposed advance payment requirements in 1990 or 1991.[83] AT&T and Lucent did not disclose to customers that these additional restrictions reduced the value of leasing.

Trade-up and Time-Based Discount Offers. AT&T represented that trade-up and time-based discount offers were developed in response to consumer group concerns[84] and that they "increase customer value perception." In reality, these discounts generally have been offered only as a save procedure to retain customers who want to stop leasing, to AT&T and Lucent's benefit. The trade-up offers were designed to be profitable for AT&T, with break-even points of 26-42 months,[85] and the time-based discounts lock in customers who are inclined to stop leasing otherwise.

Responsibility for Billing Discrepancies. The 1999 Lease Service Contract states, for the first time, that, "You are responsible for reporting any billing discrepancies within 90 days of the billing in question." Lucent has not disclosed to customers whether this new requirement limits a customer's ability to obtain adjustments for billing problems reported after 90 days.

The lease program has been designed and/or modified so that, in AT&T and Lucent's opinion, requirements of various consumer protection statutes[86] are avoided. Their attitude has been to live by the letter rather than the spirit of consumer protection laws.

AT&T and Lucent have been of the opinion that a lease term of no more than three months would avoid the need to comply with the Consumer Leasing Act (part of the Federal Consumer Credit Protection Act),[87] whose purpose is "(t)o enable consumers to have enough information about a lease to be able to make a decision on whether to enter into a lease or to purchase the product." AT&T and Lucent reported that making the lease four months or less enabled avoidance of disclosure requirements such as total payments, purchase options, liabilities at the end of the lease, the name of the leasing company, and termination charges[88] and avoidance of limitations on early termination charges and equipment recovery charges.[89]

AT&T discontinued the sale-in-place offer for month-to-month leasers because of concerns about state laws and regulations regarding rental-purchase agreements.[90] Lucent stated that not allowing customers to buy their in-place telephones allows the lease program to avoid state rental-purchase agreement laws.[91] Lucent pointed to what it called "onerous" provisions in state rental-purchase agreement laws, including automatic ownership transfers when rental payments exceed a certain level, e.g., 200% of the cash price; customer signature requirements; and a requirement that the purchase price of the leased product be disclosed.[92]

AT&T opposed pending consumer protection legislation, including legislation that would broaden the definition of rental purchase agreements, address unconscionability and liquidation of damages, expand the scope of a retail installment sales act to cover leases not already covered, and require contracts for small amounts to be in writing and signed.[93]

C. AT&T and Lucent Have Erected Unfair and Unreasonable Barriers to Lease Termination and Have Taken Other Actions to Exploit Customer Inertia

AT&T and Lucent have created and maintained unfair and unreasonable barriers to lease termination, and have encouraged and exploited customer inertia[94] in numerous ways. Their attitude has been "don't shake the inertia tree" by doing anything that would make it more likely that customers would stop leasing.[95]

AT&T was aware that lease bills acted as a trigger that could spur lease termination.[96] Billing practices have avoided bringing the lease to the customer's attention.[97] AT&T implemented quarterly billings for most customers--out of sight, out of mind.[98] At the same time, the use of monthly rather than quarterly bills for the small portion of customers with the highest bills makes it less likely that a large bill would spur the customer to action. The $12/month limit for quarterly bills ($36/quarter) was suspended following the 1994 price increases[99] and later raised to $14[100] in order to minimize or avoid changes in billing frequency. There is no legitimate business reason for billing some accounts quarterly and some accounts monthly. The Automatic Lease Payment Plan implemented in 1994 or 1995[101] also makes lease bills less noticeable to customers[102] and withholds information provided in monthly bills, such as bill inserts and the 800 number,[103] thereby contributing to inertia. Lease bills were unclear, as discussed in Section III.E, and omitted itemized information, which may have caught the customer's attention. AT&T instituted monthly bill itemization over ten years after divestiture, and only after pressure from consumer groups and the Federal Trade Commission (FTC).

Lack of customer knowledge creates inertia. AT&T and Lucent actions or inactions that have contributed to lack of customer knowledge add to this inertia. The failure to disclose full terms and conditions and changes in those terms and conditions, as discussed above, and the failure to disclose the likelihood that repairs would be needed[104] make it impossible for customers to fully compare lease and purchase options. AT&T and Lucent have not provided customers with a comparison of the cost of purchasing a phone compared with the total expected lease payments before a telephone would need repair. The purchase offers made to lease customers were for high-end equipment not directly comparable to the leased telephones, and with confusing prices, e.g., a cordless telephone for $22.49 per month for four months plus shipping and handling,[105] so that it has been difficult for customers to compare lease and purchase alternatives. Confusing and misleading bills and other customer communications, discussed in Section III.E, make it difficult for customers to understand the bill, what they are leasing, and what alternatives are available.

Customer actions required to terminate a lease contribute to inertia. Several AT&T and Lucent actions or inactions have made lease termination more difficult and thus have discouraged customers from terminating. AT&T and Lucent have not fully disclosed the steps that a customer must take to terminate a lease, as discussed above. Once fathomed, the multi-step termination process is daunting: a customer has to find the 800 number, call (or call back) during hours when the computer system is operational, get through a possibly lengthy period on hold, resist the save attempts, modularize (if the phone is hardwired), mail or take the phone to a service agency (or previously a Phone Center), confirm that the phone was received (if mailed in), and confirm that the billing has been terminated appropriately. Call centers have been understaffed, so that customers could have long waits on hold.[106] Reductions in the number of Phone Centers, their eventual closure, and reductions in the number of service agencies have made it more difficult to return phones. Customers have not been told of the free mail-in option as an alternative to making a trip to a service agency or Phone Center to return a telephone and terminate the lease.

The requirement that customers turn in hardwired phones in order to terminate their lease is a significant barrier to lease termination for customers with hardwired phones. Such customers predominantly are older, have lower incomes, and are less educated than leasers with modularized telephones.[107] While modularization may be fairly straightforward in some instances, that is not always the case. Modularization kits have bare-bone instructions.[108] Even AT&T's more-detailed modularization guides developed in 1995[109] do not address complications that may arise in older homes or if the existing telephone wiring does not conform to standard practices.[110] Wall phone connections are much more difficult to modularize than are desk phone connections.[111] People with only one telephone[112] face additional impediments because they cannot eliminate the shock hazard by leaving one plugged-in phone off-hook; nor do they have a working phone for backup if problems arise while modularizing. Further, even if a customer has a modular network interface device installed by the local telephone company where the telephone wires enter the premises, AT&T's instructions do not inform customers that unplugging the inside wiring from the network interface device is another method of eliminating the shock hazard. AT&T was aware that many customers and LSC associates perceived modular conversions as too difficult to complete.[113] The high charges for premises visits act as a further barrier to lease termination for a hardwired customer. Customers who have resorted to premises visits for modularization have reported high levels of anxiety and insecurity, as well as physical impediments, which prevent them from modularizing their telephones.[114] Additionally, AT&T's lack of disclosure regarding the level of ERC charges, discussed above, prevents an accurate assessment of the option of keeping the hardwired phone and paying the ERC, as an alternative to modularization.

When a customer calls wanting to terminate the lease or buy the phone, various "save" tactics are used that are designed to feed on customer inertia. These are discussed in Section III.F below.